Public Document Pack

Enterprise and Business Committee

Meeting Venue:
Committee Room 3 – Senedd

Cynulliad Cenedlaethol Cymru
National Assembly for Wales

Meeting date:
21 November 2013

Meeting time:
09:15

For further information please contact:

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Agenda

Pre-Meeting in private (09.15-09.30)

FORMAL PUBLIC MEETING (09.30)

1 Introductions, apologies and substitutions

2 Structure of the Rail Industry: evidence from The Centre for Research on Socio Cultural Change (09.30-10.30) (Pages 1 - 53)

Witnesses:

- **Karel Williams,** Professor of Accounting and Political Economy, Manchester Business School, Director, ESRC Centre for Research on Socio Cultural Change

Supporting documents:
EBC(4)-40-13(p1) – The Conceit of Enterprise: Train Operators and Trade Narrative
Private paper (Members' Briefs for Items 2 and 3)

BREAK (10.30-10.45)

3 TEN-T and CEF Regulations (Videoconference) (10.45-11.45)

Witnesses:

- Herald Ruijters, DG Mobility and Transport (MOVE), European Commission
- Philippe Chantraine, DG Mobility and Transport (MOVE), European Commission

4 Papers to note (Pages 54 - 76)

Supporting documents:
EBC(4)-40-13(p2) – Letter to the Minister for Economy, Science and Transport
EBC(4)-40-13(p3) – The Minister's response
EBC(4)-40-13(p4) - Letter to the Minister for Education and Skills
EBC(4)-40-13(p5) – The Minister's response

5 Motion under Standing Order 17.42 to resolve to exclude the public from the meeting for the following business:

BREAK (11.45-13.00)

6 De-brief and discussion on the review of work and forward work programme (13.00-13.40) (Pages 77 - 81)

Supporting documents:

Private paper: Review and Forward Work Programme

7 EU Funding 2014-2020 inquiry (13.40-14.00) (Pages 82 - 90)

Supporting documents:

Private paper: Scoping paper

CRESC PUBLIC INTEREST REPORT

The Conceit of Enterprise: train operators and trade narrative

CRESC Response to ATOC's 'Growth and Prosperity' Report

Andrew Bowman, Peter Folkman, Julie Froud, Sukhdev Johal, John Law, Adam Leaver, Michael Moran, Karel Williams

EMBARGO

00:01 WEDNESDAY 4th September 2013

Centre for Research on Socio-Cultural Change

THE CONCEIT OF ENTERPRISE: Train operators and trade narrative[1]

Andrew Bowman[a], Peter Folkman[a], Julie Froud[b], Sukhdev Johal[c], John Law[d], Adam Leaver[b], Mick Moran[b], Karel Williams[a]

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Summary: About This Response

The train operators have countered CRESC's *Great Train Robbery*, a critical TUC sponsored research report. Richard Branson defended Virgin's record in a Guardian column and ATOC, the train operators' Trade Association, weighed in with its own report *Growth and Prosperity* based on KPMG research.

CRESC's rejoinder "The conceit of enterprise" now argues that the result is dispute without debate. Because the train operators defend themselves by restating what we call a "trade narrative" (pp.5-6) about how private operators deliver social benefits. This is part of a much larger political problem about how privatisation and out sourcing entrenches corporate players with self- serving narratives that overestimate their contribution (pp.25-26).

ATOC, like Richard Branson, emphasise how direct subsidies for operators have declined but do not engage with CRESC's original arguments about how low track access charges provide a large indirect subsidy to all train operator (pp.16-18) within a dysfunctional system where the state and the taxpayer fund rail investment and guarantees Network Rail's increasingly unsustainable debt mountain.

Instead the operators divert onto claiming that it is their marketing effort rather than GDP growth which drives increasing passenger numbers. As our rejoinder points this claim is doubtful (pp.8-10) and flatly contradicted by ATOC's own lobbying demand that train operators should be compensated for GDP fluctuations which constitute an uncontrolled risk (p.9).

[1] A free copy available to download from http://www.cresc.ac.uk/publications/the-conceit-of-enterprise-train-operators-and-trade-narrative

More fundamentally, the train operators emphasise that their dividends are modest and return on sales is lower than in supermarkets. But they do not confront the existential issue of why we need private train operators who receive large subsidies, invest almost no capital and take very little risk because they can and do walk away from loss making franchises with modest penalties and no claw back.

Contrary to Richard Branson's claims, over the 15 years life of the West Coast franchise, Virgin is hugely subsidy dependent. Net direct subsidy alone amounts to nearly £2billion (p.18) and indirect subsidy through low track access charges has increased in recent years as direct subsidy declines (p.20). These subsidies have allowed £460 million to be paid out as dividends (p.18).

The report aggregates the results of all the private train operators (p.15 –and reproduced below) and shows they have just £219 million of capital employed on which they earn a pre-tax ROCE of 121.8% (whereas publicly funded Network Rail has £36 billion of capital employed on which it has a wafer thin return of 1.34%).

What train operators will not admit is that it is easy to make distributable profit (or exit with modest penalties when the economy turns down) in an industry where the tax payer provides the capital and operating subsidy.

The Conceit of Enterprise:
rail operators and trade narrative

Introduction

> *"The franchising model has enabled train companies to generate significant financial returns for the Government, played a crucial role in delivering unprecedented growth in journey numbers, and provided passengers with improved services and better value."*
>
> *Growth and Prosperity*, Page 29, Association of Train Operating Companies, July 2013.

> *"You've got to accentuate the positive,*
> *Eliminate the negative,*
> *Latch on to the affirmative*
> *Don't mess with Mister In Between"*
>
> Johnny Mercer, *pop standard lyric,* 1944.

The TUC published CRESC's public interest report, *The Great Train Robbery*, in June 2013 in order to encourage debate about the public interest issues around rail finance.[2] The report offered the first comprehensive account of how public subsidies and guarantees have created a rail system which operates through subsidy 'churnaround'. The requirement for railway subsidy is driven by the basic fact that passenger revenues do not even cover operating costs, let alone investment. But then the structure of the privatised railway industry means that those subsidies are churned around the system from one location to another. This movement obscures the extent and the form of subsidies and gives private train operators an option on distributable profit while losses and debts are absorbed by quasi-public Network Rail. The unsustainable and rapidly increasing debt of £30 billion accumulated by Network Rail is a liability guaranteed by the taxpayer.

The report's criticism of the Train Operating Companies (TOCs) was reported by Aditya Chakrabortty in the *Guardian*. This provoked a personal response from Richard Branson, headlined "hard work, not handouts, put Virgin trains on the right track", which disputed the CRESC interpretation. The Association of Train Operating Companies (ATOC) riposted in a more corporate manner by publishing its own report, *Growth and Prosperity,* based on research commissioned from KPMG. Without mentioning the CRESC report, ATOC told a different story summarised in its report subtitle: "how franchising helped transform the railway into a British success story". At the same time the Office of Rail Regulation (ORR) published its long-term

[2] *The Conceit of Enterprise: rail operators and trade narrative* is available at http://www.cresc.ac.uk/publications/the-conceit-of-enterprise-train-operators-and-trade-narrative

regulatory statement, *Opportunities & challenges for the railway,* which gave an official view of the state of our railways.[3]

So there is a debate about the organisation and financing of our railway network. That's the good news. That is what we were hoping for when we wrote the *Great Train Robbery*. But now the bad news. Where have we got to in that debate? The answer is, not so very far. The ORR knows that there's a potential problem. How will Network Rail service its debt? The ORR'S answer is that it will depend on direct government support, and long-term investor confidence. And it thereby ducks the question of sustainability while adding that '[t]he burden on future generations to pay for the costs of historic investment will continue to rise as Network Rail's debt grows to fund further investment.' (p. 34) Branson and ATOC both avoid this investment issue completely and instead focus on the operating contribution being made by the supposed managerial initiative and enterprise of the Train Operating Companies. They don't engage with CRESC's broader account of the public interest issues about rail funding and the growth of public liabilities. Instead, they choose to restate an existing storyline about private turnaround. The latter, they tell us, is due to the good work of the Train Operating Companies.

This line of defence is part of a new style of post-1980s politics that works by framing sectoral stories in a very specific way. Private business now represents itself in what we might think of as 'trade narratives'. Trade narratives describe how the good work by private firms in a specific sector creates public benefit. Indeed, they *take it for granted* that this is the case. So the basic good news story-line is always the same and the sub text is that private provision is needed if we are to secure the public good. The trade narrative is nuanced because it can make space for the idea that private providers compete to do the job better than others: think of the 2012 contest between Virgin Rail and FirstGroup for the West Coast Main Line franchise. This means that the narrative is capable of generating debate or controversy. But even as the protagonists squabble, it is written into its basic assumptions that private provision of public goods is what is needed. There is no space in the story-line for anything different. Political or economic discussion of alternatives is choked off. Problems that don't fit with the story-line disappear from view. This is what is now happening with the ATOC and Branson rejoinder to the CRESC report. Network Rail's growing indebtedness? It doesn't begin to get a look-in.

Perhaps we should not be surprised. Major institutions and organisations (public and private alike) are always reluctant to accept and take responsibility for any harm they might have done. There is nothing unprecedented or unexpected about the recent prevarications of the British NHS on unsafe hospitals. But since Thatcher and Reagan something new has happened. A world

[3] Aditya Chakrabortty, "The truth about Richard Branson's Virgin Rail Profits", *The Guardian*, 11th June, 2013, http://www.guardian.co.uk/commentisfree/2013/jun/10/truth-richard-branson-virgin-rail-profits; Richard Branson, 'Hard work, not handouts, put Virgin trains on the right track, *The Guardian*, 21st June, 2013, http://www.guardian.co.uk/commentisfree/2013/jun/20/virgin-trains-handouts-track; Association of Train Operating Companies, *Growth and Prosperity: how franchising helped transform the railway into a British Success Story*, July 2013, http://www.atoc.org/download/clientfiles/files/ATOC%20Growth%20and%20Prosperity%20report.pdf. Office of Rail Regulation, *Opportunities & challenges for the railway: ORR's long-term regulatory statement,* http://www.rail-reg.gov.uk/upload/pdf/long-term-regulatory-statement.pdf

in which corporate business now provides public services is also a world in which those providers have sharpened their narrative skills – in the form of trade narratives. We learn again and again that *public* good depends on *private* business through trade narratives which are different in various sectors but use similar strategies and devices. The general strategy is, as in Johnny Mercer's pop standard lyric, to accentuate the positive and eliminate the negative. This approach always leaves much undisclosed and unexplained because the brightly-lit foreground of positives includes black boxes whose internal operations are unexamined against a shadowy background of opaque processes. Where negatives cannot be denied or glossed over they are excused in various ways so that they either don't count as big negatives, or they become somebody else's fault. Of course, all stories work by imposing order and all knowledge works with an undisclosed, but the problem with trade narratives is that the adopt Johnny Mercer's "accentuate the positive" principle of constructing relations and selecting facts. So there are the things that we predictably don't learn about. Trade narratives don't tell us about the downsides. They don't tell us about the problems. They don't talk about the places where private interests don't line up with the public good. In short, they limit public debate, and they frame it in particular and restricting ways.

All of this is dangerous. But it is especially damaging in sectors such as finance or railways in which the profits of private corporations are levered on the state to the disadvantage of citizens and tax payers. It is even more dangerous if the system that has grown up is also unsustainable. Many would concur that the present organisation of the finance sector cannot be sustained. *But the same is true, too, for the railways*. At some point in the next decade the cost of servicing Network Rail's borrowing will lead to crisis that has to be resolved by passing liabilities on to the tax payer. But in the meanwhile the stories told by the Train Operating Companies ignore this reality. Instead they tell us about their own excellence. These trade narratives are conceits in the exact OED sense of the word. They reflect the private sector's "overweening opinion" of itself and an "overestimation of its own qualities"

The conceit in rail takes the classic form of a trade narrative in which the private provider claims all the credit for and exaggerates social benefits, while simultaneously denying or ignoring any social costs: as in other sectors, private firms are always the heroic transformers. The rail narrative is about turnaround delivering (net) payments to government and more journeys by satisfied passengers; just as the finance sector's trade narrative is about its social contribution through taxes paid and employment created. Both deal in half-truths confected from decontextualized facts and implying causal relations that would not be endorsed by independent researchers.[4] This isn't surprising. The empirical support for trade narratives in railways, finance or other sectors is provided by consultancies whose brief is to find and measure social benefits that will put private interests in a favourable light. This kind of "all benefits, no costs" analysis makes it a democratic duty to contest such trade narratives. And this is why we have written this rejoinder. In the next section we question ATOC's story about the achievement of the TOCs in increasing passenger numbers and contributing to the

[4] CRESC, *An Alternative Report on Banking Reform*, Manchester: CRESC, 2009, http://www.cresc.ac.uk/publications/an-alternative-report-on-uk-banking-reform

Exchequer. Then we consider Richard Branson's claims about a single enterprising train operating company, West Coast Trains. We treat the trade association and the entrepreneur separately because they develop the turnaround story of private success in different ways. The ATOC report fights numbers with numbers, while Branson fights numbers with imagery about one Train Operating Company on a "mission impossible".

ATOC on "the significant contribution" of franchising

> *"This original research underlines the significant contribution rail franchising has made in reversing the industry's fortunes, delivering exceptional journey growth and substantial passenger benefits"*
>
> *(Tim O'Toole, CEO of First Group in his foreword to the ATOC report)*

The ATOC report provides a generalised and sober version of the turnaround story which is aimed at Whitehall and Westminster where the trade association needs to be taken seriously by the civil servants and politicians who set the rules of the franchising game. This is why ATOC commissioned KPMG to do research that would more securely establish the connection between the TOC's enterprising management and social benefits. The benefits mentioned include increasing numbers of journeys and increased customer satisfaction. The broader claim is that operators are "generating more revenues [and] helping to reduce public subsidies and sustain investment while earning modest operating margins". KPMG's report takes the form of empirics and argument that support what the Train Operating Companies behind ATOC want to believe.

So what is the problem? The answer is that KPMG's story accentuates the positive and eliminates the negative in an intellectually opportunist and trade- framed way which (as we will argue) also unintentionally exposes the weakness of ATOC's position. The report is opportunist because it displays inadequate intellectual caution in the way it selects and slices evidence as it seeks to prove its point about causal relations and performance outcomes. Indeed – we'll come to this in a moment – such is its zeal in seeking out evidence that fits what it wants to say that it makes claims that flatly contradict what ATOC is saying in other contexts. And the report is trade-framed – and therefore flawed – because it focuses on positive issues such as customer satisfaction or dividend extraction, where the TOCs can look good, while misrepresenting the relations between subsidies and TOC contributions to government revenues. Overall the effect is to exaggerate the TOC's social contribution in ways that discourage sensible debate about rail funding and the social costs of privatized rail in terms of accumulating public liabilities.

On causal relations, the major issue in dispute is whether the TOCs can claim the credit for increasing passenger numbers. On this, the CRESC *Great Train Robbery* report argues that claims from ATOC that train operators should take the credit are highly questionable. First, passenger numbers were increasing before privatisation. But second, there are three key drivers that have nothing to do with the quality of TOC services: the long-term growth of GDP;

an increase in commuting in the South East; and the increase in motoring costs over the period in question. All of these could all be expected to have a major impact on the attractiveness of rail. At the same time, we concluded our discussion of drivers in that report by stressing the limits to existing knowledge and saying that: "a larger and more detailed research study is required if the aim is to unpack all the drivers of increasing rail passenger numbers since the mid-1980s."

The complexity of the drivers of passenger train travel is noted by David Higgins, Chief Executive of Network Rail. Higgins emphasises the "key role" of train operators in his foreword to the ATOC report but adds that:

> *"[Journey] growth is driven by a multitude of factors. Social and economic changes within Britain have a big role to play. As more jobs are located in city centres but people's homes are in suburbs, or even different towns, commuting has increased markedly. The growing role of communications technology in our everyday lives also means that people have wider social networks and are more likely to travel to visit friends and family who don't live nearby. Alongside these changes to the way people live and work, the cost of fuel, running a car and road congestion all impact on the number of people who travel by rail."*

The problem is that ATOC (and KPMG) want to claim all the credit for the train operators before the research is done. This means that they beg the question in ways that prejudge the answer about what is driving rail's success. KPMG write:

> *"... if external demand drivers and other factors cannot alone explain rail's success, what part has been played by franchising where train operations are focused on delivering what customers want?"*

ATOC and their members believe the KPMG report vindicates their answer. First Group chief executive Tim O'Toole writes in his foreword:

> *"How did this happen? How do policy makers distinguish causation from correlation? This report, based on data collated and analysed by KPMG, provides important evidence to demonstrate the essential role franchising and private sector operators have played in the success of the past 20 years."*

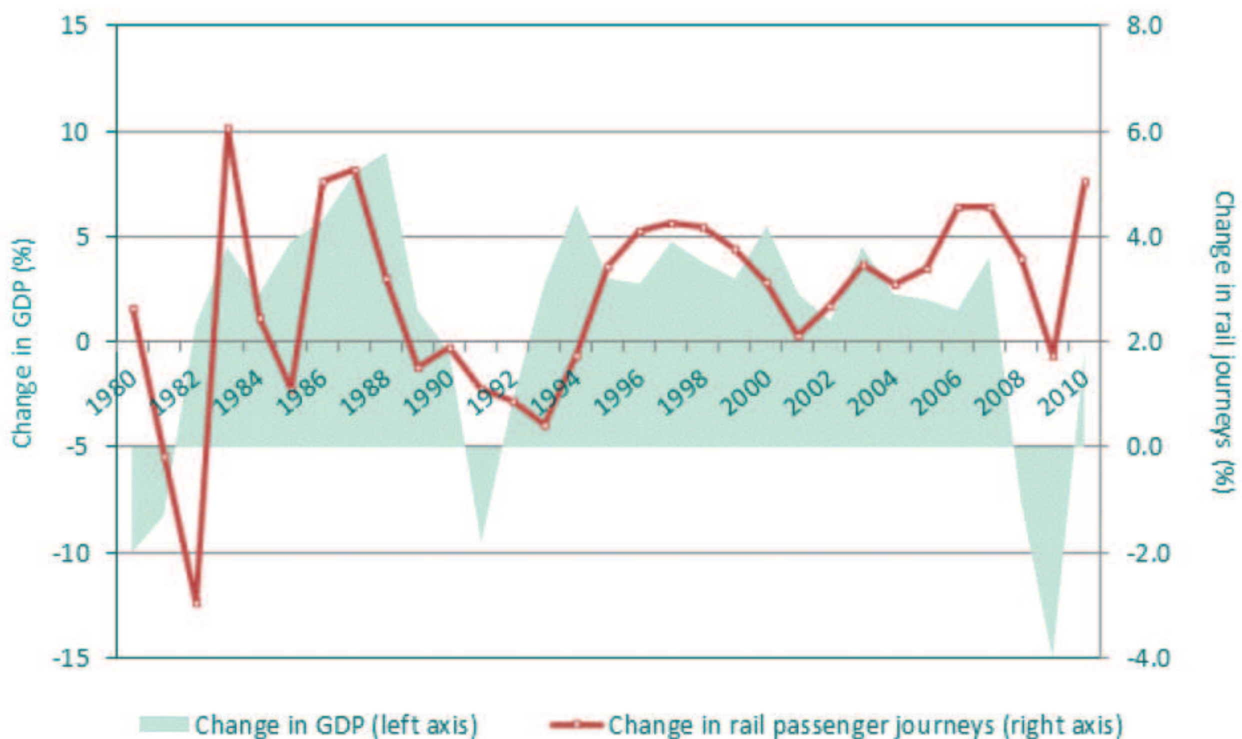
But, those who read the text closely will find that the report does not establish that "success" would have been impossible without franchising. The first and most obvious issue in the report is KPMG's use of evidence on the causal relation between GDP growth and passenger numbers – we'll come to this in a moment. The second is the gross contradiction about causal relations that we touched on above. The ATOC report plays down the importance of GDP as a driver of passenger numbers. But exactly the opposite is claimed when ATOC goes into lobbying mode about the terms of franchise agreements. Wearing another hat, the trade association has argued that franchisees should be compensated for fluctuations in GDP because these are a driver of revenue fluctuation and risk that lie beyond the control of the TOCs. So that is the argument. But what does the evidence – incomplete though it may be – actually suggest? Did

GDP growth drive the increase in rail passenger journeys, or was it the management of the train operators?

The first decade of privatisation coincided with the longest post-war period of sustained economic growth and correlated with an increase in the number of commuters and in the number of leisure trips. If the aim is to unpack causality, we would argue that time series evidence should be presented for the whole of the relevant period so that readers can inspect trends and make their own calculations for sub-periods. This was what we will do later in this rejoinder when considering the numbers for West Coast Trains (Exhibits 3, 4 and 5). And this was also what we did in the *Great Train Robbery* report when we presented GDP growth and rail passenger journeys with all the time series data on both in a single 30 year chart. This is reproduced below as Exhibit 1 which shows how changes in rail journeys have been highly sensitive to changes in GDP.

KPMG did not do this. Instead they sliced the data into 14 year sub-periods in a way that makes moving trends and relationships between GDP and rail growth invisible. In their pre-privatisation sub-period, GDP grew 53 per cent and rail journeys by 33 per cent, whereas in the post-privatisation sub period, GDP grew 33 per cent and rail journeys by 73 per cent. KPMG then conclude that "the correlation between the two is far from complete". But they are only able to make this claim because of *their choice of sub-periods*. The correlation is far stronger than they are suggesting.

Exhibit 1: Percentage change in GDP vs. change in rail passenger journeys[5]



[5] Source: ORR / DfT / IMF.

As we noted above, there is another irony, this time about the contradictions between the stories told by ATOC to different audiences for different purposes. As we have just seen, in its trade narrative where it talks up the social benefits of franchising, ATOC's position is that GDP growth plays no major role in driving rail passenger journeys. But in its lobbying efforts where it reflects the private interests of its members in minimising risk, ATOC has argued that franchise agreements should contain compensation for GDP fluctuation. Why? Because changes in GDP lead to changes in TOC revenue that are beyond the control of the TOCs, *because GDP changes drive passenger numbers*. Thus if we turn from the KPMG report to the ATOC web site, we find documents which imply or assert these relations as part of an argument about uncontrollable macro risk. In its 2010 publication *Franchise reform and better value for money in rail*[6] we read that:

> *"ATOC believes better risk–sharing is vital both to promote stability in the industry and to build long-term value. We identify seven options, including an earlier start to revenue support in a franchise, linking franchise payments to GDP..."* (Page 8)

And in another 2009 ATOC report, *Franchise Reform a better railway for passengers and for taxpayers*[7] they argue for the:

> *"Indexation of franchise payments according to the rate of change (up or down) of GDP over the previous 12 months. This is in effect a variation of revenue support particularly focused on providing a better structure to handle major economic downturns, a risk that the franchisee cannot control ..."* (page 18)

The Appendix of the report adds that:

> *"Since passenger demand and GDP for most franchises are thought to be quite closely correlated (at least over the long term), this would increase the chance a franchise could withstand a serious recession (a risk that the TOC cannot control)"* (page 24)

So the lobbying story about private risk is quite different from the trade narrative about public benefit. But note, too, that the trade association's lobbying proposal is for indexation over 12 months; we believe there would be uproar from ATOC members if the proposed indexation was to be over 14 year periods chosen by KPMG. Note also that as a result of successful lobbying, the new franchise payment and subsidy mechanisms are now responsive to GDP. A question then suggests itself: since the KPMG report comes to the opposite conclusion, will ATOC now campaign for the GDP mechanism to be struck out of franchising agreements so that the taxpayer can save money when GDP next turns down? If not, then the trade narrative is hypocrisy

The trade narrative is created to reflect what ATOC wants to believe about the positive benefits of franchising, so KPMG's slicing of evidence and neglect of contradiction on GDP and rail journeys is not so much a momentary lapse, as a defining characteristic of the report. Consider,

[6] Association of Train Operating Companies, *Franchise reform and better value for money in rail*, 2010 http://www.atoc.org/clientfiles/files/Cost_savings_final.pdf

[7] Association of Train Operating Companies, *Franchise Reform a better railway for passengers and for taxpayers*, 2009 http://www.atoc.org/clientfiles/files/FutureFranchisesReport_AW.PDF

for example, the importance of London and the South East in driving the growth in passenger journeys. In the *Great Train Robbery* report we presented figures from the ORR showing that just under two thirds of the increase in rail passenger journeys since 2002/3 – the earliest we could get data split by region and journey type – came from London and the South East (Exhibit 61. p. 117). It might well be the case that without the peculiar dynamics of the South East (rising house prices, longer commutes, congestion charging etc.), the growth figures would not have looked so good. ATOC and KPMG claim that because the growth of peak hour travel into and out of London has been below overall levels of growth, there is no London effect. We don't know why they choose to consider London alone and not the South East more broadly, but it is worth noting that rail use has historically been far higher in and around London than the rest of the country (regional and long distance operators have accounted for only 30 per cent of passenger journeys over the past decade). This means that a little growth around London contributes a lot of growth to the aggregate.

The contradiction between trade narrative and lobbying objectives surfaces again in ATOC's argument about the role of London and the South East. Because London and the South East are so important, ATOC suggested in the 2010 report cited above that a central London employment index could be an additional option to relieve risk for the TOCs (page 9). The view certainly appears to be held by some ATOC members. Here, for example, is Stagecoach invoking GDP and London employment as uncontrollable risks:

> *"The revenue earned by UK train operating companies is historically correlated with macroeconomic factors such as UK GDP and Central London Employment. Accordingly revenue can vary significantly due to factors outside the control of the train operating companies".*[8]

Overall, as the ATOC argument progresses, it becomes increasingly clear that KPMG is snatching whatever apparent support it can find for its prejudged view, and doing so on the assumption that readers will not consult and check against original sources. For instance, using data from the Office for National Statistics (ONS), we argued in *The Great Train Robbery* that the growth in rail journeys owed something to the faster increase in costs of motoring. From ONS sources, the costs of petrol and oil, motor vehicle maintenance, motor vehicle insurance and tax (the three major motoring expenses included in the Retail Price Index), had all risen considerably faster than rail fares since the beginning of privatisation (Exhibit 62, p.117). So how do ATOC and KPMG work? The answer is that instead of citing data from the ONS directly, they use data from a report published by the RAC in 2012, which they say shows that rail journeys "cannot be explained by car usage becoming more expensive". We were unable to locate the data reproduced by KPMG in the RAC report, and it is very important to note that the original RAC report did not make such a bold, black-and-white claim. Instead the original report makes use of the ONS index figures we referred to and notes that:

[8] Stagecoach group, *UK Rail Franchise Risk-Sharing*, no date, http://www.stagecoach.com/investors/financial-analysis/uk-rail-franchise.aspx

> *"Rail mileage has grown most rapidly for business purposes – it has nearly tripled – and there is some evidence of a partial shift of business travel from company car to rail for men* [9]

The report also highlights interesting corollary issues such as correspondence between the sharp drop-off in company car commuter travel – particularly into London – and the growth in rail travel, major declines in company car ownership in large urban areas, the decline in car use among young men, and the more rapid growth in rail travel among those without a full driving licence. Again, since there is strategic silence on these issues in the ATOC report, it appears that evidence is being picked to support pre-determined conclusions.

The KPMG report for ATOC is similarly opportunistic in its treatment of performance indicators and outcomes. The tactic is to try to close down the framing in a way that suits ATOC's trade narrative before snatching decontextualized figures to buttress that narrative. As the TOCs claim, it is indeed the case that customer satisfaction is at an all-time high based on survey evidence. But the rail sector's composite measures of satisfaction conceal as much as they reveal. As we noted in *The Great Train Robbery* report (pp. 124-127), the questions used for the Passenger Focus surveys define satisfaction by framing it in consumerist terms about service quality. We accept that these survey results can be appropriately used to establish whether passengers think their train is clean and the staff polite. This is no doubt desirable. However, they cannot be used to support the conclusion that British citizens think the current privatised rail system is preferable to alternatives. The latter question is simply not being asked. Social or political questions to do with the organisation of the rail network do not appear in passenger surveys. This isn't what they are about. So where might we look if we want to think about the politics of the railways? One answer is – opinion polls. And as our *Great Train Robbery* report notes, such polls have on several occasions reveal that a majority of the British public favour the renationalisation of the railways.

This is partly because there is widespread public dissatisfaction with fares and pricing structures. Surveys from Passenger Focus (p.126) reveal dissatisfaction with value for money partly because many passengers feel they are 'forced into paying higher prices' by the yield management systems of the ATOCs which offer cheap fares at inconvenient times; while commuters and prime time business passengers question the obverse principle which is charging whatever the market will bear – or however much the government will allow – for those who have to travel at particular times. How does ATOC handle this? The answer is that it doesn't. Instead of confronting this social issue about the conflict between public demands for access and private business models of yield management, it focuses on the offer of cheap advance purchase fares which show, for example, that 75 per cent of people travel from London to Manchester for less than £49.00. This has certainly enabled train companies to keep average costs of travel per mile relatively flat. But the practice of offering cheap, inflexible

[9] Scott le Vine and Peter Jones, RAC Foundation, *On the Move: Making sense of car and train travel trends in Britain*, 2012, http://www.racfoundation.org/assets/rac_foundation/content/downloadables/on_the_move-le_vine_&_jones-dec2012.pdf

tickets at inconvenient times also massively diminishes the social utility of rail for many in lower income groups and dumps the burden of cost recovery onto peak time travellers.

Much the same point about opportunistic research could be made about European comparisons which are included when they work for the ATOC narrative, but are quietly dropped when they do not. Thus, research from Just Economics which we cited in the *Great Train Robbery* (pp. 119-120) suggests that key average fares in the UK are substantially more expensive than in other major European nations. On this point, KPMG provides no European comparisons. Instead the report notes that growth in UK rail passenger journeys is larger than those in other key European economies such as France and Germany. Taken out of context this sounds good. However, on closer inspection it is not clear what the comparison shows. Does faster growth in the UK reflect the peculiar decline of UK rail passenger numbers in the mid-20th century that was caused by underinvestment and policies to encourage the use of cars at the expense of rail? Have factors such as motoring costs affected the attractiveness of rail transport differently in various European countries? And, most fundamentally, if key UK drivers of rail growth are exogenous (like GDP) then passenger number increases do not vindicate the UK rail system of private ownership and franchising.

The implication is that KPMG plays fast and loose with the evidence as it tries to confirm ATOC's trade narrative about the many positives that come from the good work of train operators. But here at least, most of the evidence is in the public domain and what we have is a straightforward difference of interpretation between ATOC and ourselves – a disagreement that is often about causal relations, about what has caused the growth in passenger travel. When it comes to the issues around value extraction and public subsidy, the ATOC report is more subtly politicised by the requirements of trade narrative. Here KPMG prefers to accentuate the positive and keeps the discussion on safe ground by talking about modest dividend extraction by the TOCs and declining direct public subsidy for the TOCs. It does not confront the awkward issues about indirect subsidy which have always been in the shadow of the trade narrative. As we noted above, our *Great Train Robbery* report argues that undisclosed and indirect subsidy via low tack access for the TOCs has increased as direct subsidies have diminished; and the consequence has been a boost to the profitability of the TOCs while tens of billions of taxpayer liabilities have been and continue to accumulate in quasi-public Network Rail.

On the question of dividend extraction by Train Operating Companies, the authors of the KPMG report behave rather like generals fighting the last war. The ATOC press release of 10 July 2013 introducing the KPMG report contained only one set of figures, covering two snap-shot years (1997-8 and 2011-12) which seem to show that the TOCs made a modest surplus over costs while their contribution to government had increased.[10] This fits with ATOC's trade narrative that the TOCs are now positive contributors because they pay more to government in franchise

[10] ATOC, *Passenger Growth helps rise big rise in money to reinvest in rail services*, 2013, http://www.atoc.org/media-centre/latest-press-releases/2013/07/10/passenger-growth-helps-drive-big-rise-in-money-to-reinvest-in-rail-services/

premiums than they claim as (direct) subsidy from government. This is a reply to an earlier form of criticism to privatised rail which added up the totals for dividends extracted and argued that all would be well with railways if they were brought back into public ownership. *The Great Train Robbery* report did not argue against privatisation in this way. Instead it took a more practical line by identifying long-standing problems with rail funding. These, it said, arise from the business model of recovering costs from users. Under public and private ownership since the 1940s, rail fares have never covered operating costs and investment requirements, and adding or removing dividend extractions makes no difference to this fundamental social problem.

The CRESC report is in explicit agreement with the KPMG report that TOC dividend extractions are "modest". Indeed, this was the exact word we used in our report (p. 29) to describe the £160 million of dividends paid out by TOCs in 2010-11 which we calculated as 2.1% on turnover (p. 30). This fits with KPMG's calculation for 2010-11 of the TOCs 3.1% operating margin on turnover (KPMG, p. 13). What we disagree about is therefore not the figures, but whether this is a fair and necessary reward for private management services rendered by the TOCs.

The standard measure of return is usually return on capital employed (ROCE) because that is the basis on which any portfolio or direct investor would compare investment opportunities. The KPMG report avoids ROCE calculations, and opportunistically claims that supermarkets earn margins of around 5% on turnover, which are higher than the 3% earned by the TOCs.[11] But that glosses over a fundamental difference between TOCs and supermarkets. The supermarkets are in a stores and stocks business where they have large amounts of capital tied up in their businesses, whereas TOCs are what we called "fee for service" companies. This is because the investments they make are negligible (p. 80). They don't have capital invested in the tracks that their trains run on. And they don't have capital invested in those trains either. They rent their rolling-stock from ROSCOs (Rolling Stock Operating Companies) and they rent the right to run those trains from Network Rail.

Exhibit 2 presents the relevant evidence on returns on turnover and capital for 2011-12. These will make most readers distinctly queasy about what the rail regulator is doing to protect the public interest. The big three British-owned supermarkets (Tesco, Sainsbury and Morrisons) have £42.7 billion of capital invested in their business, and their pre-tax profit on turnover of 3.4% translates into a return on capital of just 8.5% which is towards the bottom end of what the stock market requires from utility type operations. Compare this with the 22 TOCs which in the same year had a negligible £219 million invested in the rail business. This meant that their 2.8% on sales translated into a starry 121.6% return on capital, a figure well above the expectations of return in a heavily levered private equity fund. As private equity knows, the only way to get operating ROCE above 25% is by persuading somebody else to supply most of the capital so that fund returns are levered. This is the explanation for the 121.6% ROCE of the TOCs because, from a rail system point of view, Network Rail is supplying the capital so that the TOCs can earn profits. As Exhibit 2 shows, Network Rail has £35.8 billion of capital invested in infrastructure so that its pre-tax return on sales of 7.6% translates into a return on capital of

[11] Dataset accompanying the ATOC report.

1.3% which the financial markets would deem inadequate. If we then counterfactually reintegrate the system by combining Network Rail and TOC accounts for 2011-12, the system-wide return on capital is just 2.1% ROCE (because railways cannot recover costs from users, whether under public or private ownership).

Exhibit 2: A comparison of capital employed, profit, return on sales and return on capital employed[12]

	Long-term debt and shareholder equity £m	Pre-tax profit £m	Pre-tax return on sales %	Pre-tax return on capital employed %
Supermarkets	42,683	3,627	3.4	8.5
Train operating companies	219	266	2.8	121.6
Network Rail	35,846	475	7.6	1.3
Counterfactual: Network Rail and TOCs combined	36,065	741	2.1	2.1

Is there any justification for TOC profits? What's important is not the size of the margin *per se* but whether the 2-3% TOC charge on revenue and more than 100% return on capital is the price that has to be paid – is appropriately paid – for efficient management of train operations. The ATOC report does not ask this question, because the question does not enter the frame. So what's the right answer?

In our report we argued that private ownership, profits and dividends are quite unnecessary. First, we noted that state-owned, vertically integrated, British Rail had a commendable record of operating efficiency in its latter days in the 1980s (p. 138). Second we suggested that the state-owned Directly Operated Railways (DOR) is a crucial and contemporary test. This is because its management currently delivers high levels of performance on the East Coast main line (pp. 127-8) without profit incentives – and after private franchisees have walked away. KPMG chooses not to engage with either of these points.

[12] Source: FAME, BvDEP. There are 22 train operating companies used in this table. They are Abellio Greater Anglia Ltd, Arriva Trains Wales Limited, C2c Rail Limited, Directly Operated Railways Limited, East Midlands Trains Limited, First Capital Connect Limited, First Greater Western Limited, First Scotrail Limited, First/Keolis Transpennine Limited, Grand Central Railway Company Limited, Heathrow Express Operating Company Limited, Hull Trains Company Limited, London & Birmingham Railway Limited, London & South Eastern Railway Limited, London Overground Rail Operations Ltd, Merseyrail Electrics 2002 Limited, Northern Rail Limited, Southern Railway Limited, Stagecoach South Western Trains Limited, The Chiltern Railway Company Limited, West Coast Trains Limited, XC Trains Limited. The supermarket group includes Morrison, Sainsbury and Morrisons. In all cases the latest year's accounting data is used. Supermarkets reported in the first 3 months of 2013.

So whether the public needs private and profit-earning TOCs is, to put it mildly, an open question and the rail regulator certainly needs to cap TOC returns on capital. But more fundamentally, KPMG and ATOC do not engage with the main thrust of our report which is that privatisation is a charade or pretence sustained by subsidy churnaround which suits the TOCs (because it gives them an option on profits) and suits the Department for Transport (DfT) (because its political masters would otherwise have to admit failure as franchising collapsed). Thus the KPMG report makes great play of the fact that (direct) subsidies to the TOCs have declined. But it does not recognise that this is a completely meaningless indicator. This is because, as *The Great Train Robbery* argues, *indirect subsidy of TOCs via low track access charges has increased as direct subsidy has declined*. Indeed this has reached the point where indirect subsidies are now typically much larger than direct subsidies (pp. 75-9). The cost of this arrangement falls on the public in ways not considered in the KMG report. Since focus of the latter is in vindicating the TOCs, it has no interest in analysing the larger issue of how taxpayers and citizens are paying to subsidise Network Rail and guaranteeing its debt. This is the crucial fact that is hidden in the shadows of the trade narrative. *Public operating subsidy of Network Rail has increased from £1bn in 2002 to £4-5bn a year since 2006* (p. 75). At the same time Network Rail has meanwhile financed the cost of rail investment (not covered by operating subsidy) by issuing some £30bn of public debt. Consequently, Network Rail is now spending more on debt service than on track maintenance (p. 85).

But the KPMG report is silent on this mess. We conclude that public costs do not matter to the TOCs as long as they retain a franchising system which minimises their risk and gives them an option on private profit. This is frightening. And it also points to an even larger problem. It suggests that this is what is likely to happen if you entrench private corporate interests in a utility with an operating cost recovery problem and a large investment requirement. We can then expect the private trade narrative to accentuate the positive in ways that occlude proper discussion of the public interest. In the case of rail, the trade narrative won't talk about – has no space for – the fact the Network Rail's debt mountain, already growing, will in due course become unsustainable.

Richard Branson's "mission impossible" on the West Coast line.

> *"We were told that it was 'mission impossible' and our plans were laughed at by critics.*
> *....*
>
> *[However 15 years later]...Under our stewardship, the West Coast Main Line has been transformed from a public liability into a valuable asset for the UK, worth many billions of pounds. The service is a British success story and one to put up against rail companies around the world" (Richard Branson, Virgin press release, summer 2012)*[13]

[13] Statement from Sir Richard Branson, Founder Virgin Group, Virgin Media Room, http://mediaroom.virgintrains.co.uk/2012/08/statement-from-sir-richard-branson.html

The turnaround story is the same but the rhetorical techniques are very different in Richard Branson's *Guardian* article of June 2013. This was a reply to a critical *Guardian* column by Aditya Chakrabortty who cited our *Great Train Robbery* report's conclusions about Virgin on the West Coast main line. Branson's response reworks a narrative which is a kind of imaginary previously invoked in a Virgin press release of summer 2012 (quoted in the GTR report p 18) issued after Virgin lost the first round of a West Coast refranchising competition. The 2012 press release and the 2013 *Guardian* article frame Virgin as the corporate hero succeeding against the odds after it embarked on "mission impossible" by taking on the West Coast franchise in 1997. The Virgin group of companies represent themselves as entrepreneur battlers, outsiders disrupting stuffy businesses such as music, airlines, banking, cola or railways in order to give the consumer the Virgin brand and a better deal than that available from larger incumbents. Tom Bower's (2000, p 237) biography presents a less heroic account of a "protecting the downside" *modus operandi*. Here Branson is described as a serial deal-maker who seeks to maximise business opportunity and minimise risk. But the battler self-image is what Richard Branson himself wants to, or does believe, when he says: "we basically look at which businesses are taking the consumer for a ride, which are making excess profits. We ask: can we do it differently than they are doing it" (Bower, 2000, pp279-80).

From this point of view, the awkward primary problem with UK railways was that they were not making excess profits either before or after privatisation. Instead they were making ineradicable losses because there is never enough money in the fare box to cover operating costs, maintenance, and new investment in track and trains (which the private sector will not fund without guaranteed returns). When Virgin won the West Coast franchise in 1997, the subsidiary problem was that nationalised BR was already running an efficient operating business and profits could not be achieved by further cost cutting. As we pointed out in the *Great Train Robbery* report, on the West Coast main line Virgin did in the long-term carve out a privately profitable niche for West Coast Trains. As we have noted above, like other TOCs it did so at minimal downside risk because it had very little capital invested in the business, and that capital earned a stellar return. But Virgin's profits came at the expense of continuing large state subsidies which were increasingly concealed from the tax paying public. As we have noted above, this was because of a political decision to provide *indirect* subsidy by lowering the track access charges paid by West Coast and other Train Operating Companies to run their trains. Analysis of this one company case therefore powerfully clarifies the general issues around the increasing reliance of train operators on indirect subsidy in a sector where profit is politically constructed.

The basic source for our argument is the accounts of West Coast Trains filed at Companies House. This company is a special purpose vehicle which has held the West Coast main line franchise since 1997 and is jointly owned by Stagecoach and a chain of Virgin companies which ends in the British Virgin Island-registered Virgin Group Holdings. Sixteen years of accounts are now available and all these years are presented in Exhibit 3 below so readers can inspect and make their own calculations. In the *Great Train Robbery* report we adjusted for inflation and

presented real values; to remove any cause for dispute, the table below presents nominal figures as given in the original West Coast Trains accounts.

Exhibit 3: West Coast Trains, direct subsidy, depreciation, profit, tax and dividends[14] (Nominal data)[15]

	Gross direct State subsidy £000	Premium payments £000	Net direct subsidy £000	Depreciation £000	Pre-tax profit £000	Tax £000	Net profit £000	Dividends £000
1997	72,250	0	72,250	152	-11,181	0	-11,181	0
1998 (11 months)	70,236	0	70,236	95	9,724	450	9,274	0
1999 (53 weeks)	71,913	0	71,913	274	38,042	15,415	22,627	0
2000	59,511	0	59,511	1,066	52,521	15,220	37,301	37,000
2001	93,241	0	93,241	1,681	38,539	13,488	25,051	24,000
2002	263,008	0	263,008	3,687	69,820	21,368	21,048	69,500
2003	360,496	0	360,496	4,745	66,782	21,845	44,937	0
2004	370,818	0	370,818	5,961	24,881	4,912	19,969	8,000
2005	212,061	0	212,061	11,756	30,135	9,769	20,366	25,800
2006	92,770	0	92,770	6,305	-13,276	-5,013	-8,263	20,000
2007	98,746	0	98,746	2,604	16,668	6,100	10,568	13,132
2008	161,905	0	161,905	425	81,254	24,799	56,455	64,000
2009	127,945	0	127,945	413	104,548	28,123	76,425	74,882
2010	77,518	0	77,518	1,587	69,440	18,808	50,632	67,000
2011	76,833	155,270	-78,437	2,665	55,712	15,764	39,948	30,500
2012 (56 weeks)	69,258	214,320	-145,062	2,128	40,775	10,989	29,786	26,000
Total 1997-2012	2,278,509	369,590	1,908,919	45,544	674,384	202,037	444,943	459,814

This means that they are slightly different from those in the *Great Train Robbery* report, but this does not change our story in any important way. As we have already noted, Richard

[14] Source: West Coast Trains Limited, 'Director's report and financial statements', various years. Company registration number 3007940.

[15] The presentation of the notes to the accounts mean that 1997-2010 gross subsidy is a net figure and include the net summation of items that reflect various arrangements including 'Revenue Adjustment' and other amendments. From 2011 the company explicitly state as a separate line 'Franchise (expense)/income'.

Branson argues that West Coast's success owes much to "hard work" and the company does not depend on "handouts". But, if we consider West Coast Trains as a long-term investment, over the life of the franchise since 1997, the company has been dependent on direct subsidy (even without considering indirect subsidy via low track charges). This means that, *over the life of the franchise from its own accounts*, Virgin is subsidy-dependent and works by extracting value rather than bringing investment into the rail industry.

As Exhibit 3 shows, since 1997 West Coast Trains has benefited from a huge direct public subsidy which (after allowing for offsetting premium payments) amounts to £1.9 billion net. This company operates in a space of politically constructed profit because, without this direct subsidy, the £674 million of cumulative profit could not have been found over 16 years. Indeed, the £202 million West Coast Trains then paid as corporation tax on profits could be understood as simply the recycling of a small part of the much larger state subsidy back to the state; because the profit on which tax is paid comes from the state not the market. In line with standard Train Operating Company practice, more or less all of the post-tax profit, some £460 million over sixteen years, has been extracted from the rail industry as dividends remitted to the corporate parents, Stagecoach and Virgin Rail Group. As we suggested above, the operating company's value extraction is not offset by investment which would bring new funds into rail. That this is the case is clear, because any large investment by West Coast Rail would reveal itself in depreciation charges much larger than the £46 million cumulatively taken over the life of the franchise.

Richard Branson's argument is that today's taxpayer is now getting something in return. This is because the steady profits at West Coast have been accompanied by a dramatic reduction in direct state subsidy (which has fallen hugely from the crisis peak after the collapse of Railtrack) so that West Coast Trains is now paying more in premiums than it obtains as direct subsidy. The problem is that this is just like the story told by ATOC. The narrative of turnaround and contribution focuses only on *direct* subsidy. It entirely fails to engage with the argument made in *The Great Train Robbery* that we have rehearsed above: that track access charges paid to Network Rail have fallen steeply. It fails, that is, to talk about the large *indirect* subsidy which supports the profitability of the TOCs – including West Coast Trains. *Track charges for the TOCs no longer reflect the economic costs of infrastructure.*

As we noted above, after 2004 direct state subsidies in the form of cash grants to West Coast Trains and other operating companies have declined, but the indirect subsidies in the form of low track access charges levied by Network Rail have increased. West Coast Trains now pays less in track access charges despite the fact that the company is running more trains with more passengers along a line that has been upgraded and renewed at cost of nearly £10 billion – a cost that was substantially charged to the taxpayer. Again, time-series empirics are helpful and Exhibit 4 below pieces together the fragments of available evidence from West Coast Trains' annual reports and Office of Rail Regulation sources. This shows how, since 2004 on the West Coast line, the number of timetabled train kilometres has doubled to 36 million but track access charges have been nearly halved since the 2004 peak of £280 million; the result is that West

Coast which paid £10 per train kilometre travelled as recently as 2008 is now paying less than £5.

Exhibit 4: West Coast Trains time-series comparison of track access charges and direct subsidy[16] (Nominal data)

	Track access costs £000s	KM miles KM mill.	Cost per KM £	Direct State subsidies £000s	KM miles KM mill.	Cost per KM £
1997	130,160			72,250		
(11 months) 1998	120,779			70,236		
(53 weeks) 1999	133,712			71,913		
2000	131,923			59,511		
2001	116,275			93,241		
2002	239,051			263,008		
2003	261,133			360,496		
2004	279,964	18.19	15.39	370,818	18.19	20.39
2005	136,495	20.02	6.82	212,061	20.02	10.59
2006	158,832	22.46	7.07	92,770	22.46	4.13
2007	210,247	22.68	9.27	98,746	22.68	4.35
2008	257,384	24.25	10.61	161,905	24.25	6.68
2009	152,752	30.01	5.09	127,945	30.01	4.26
2010	170,552	35.55	4.80	77,518	35.55	2.18
2011	136,700	35.59	3.84	76,833	35.59	2.16
(56 weeks) 2012	161,175	35.88	4.49	69,258	35.88	1.93
Total 1997-2012	2,797,134	244.63	11.43	1,287,854	244.63	5.26

Richard Branson's *Guardian* article briefly recognises these issues before trying to explain them away. It notes that national track access charges for use of infrastructure by Train Operating Companies have been more or less halved in the past decade before explaining that track access charges "are set by the government, and the west coast charges reflect a reduction in costs after the renewal and upgrade work." This explanation is fact followed by an (incredible) excuse typical of trade narrative in its denial mode. As the *Great Train Robbery* report details,

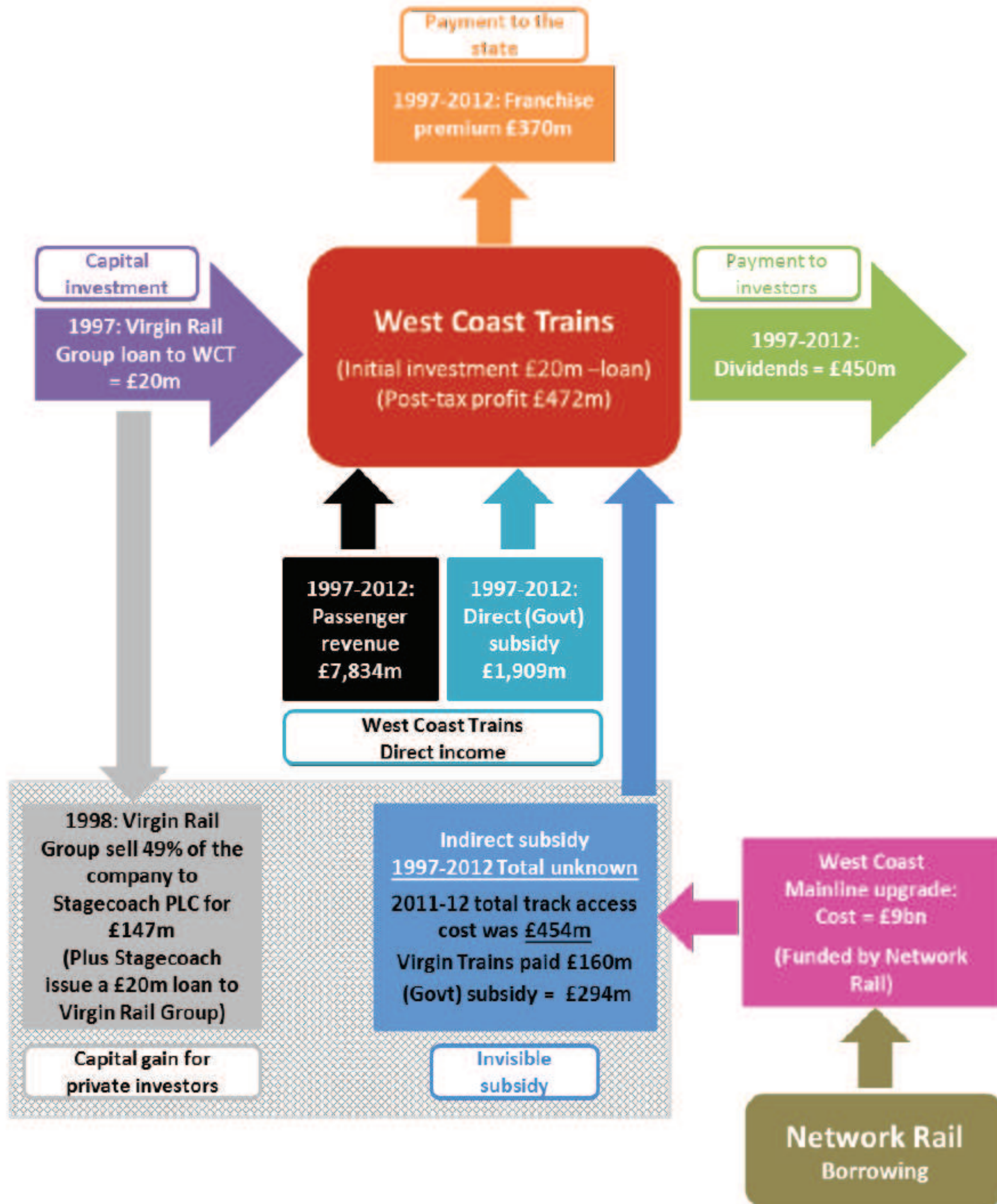
[16] West Coast Trains Limited 'Director's report and financial statements', various years and 'National Rail Trends' (NRT), Office of Rail Regulation.

the fact is that lower track access charges were politically expedient for the Treasury because they keep the costs of rail subvention out of the Public Sector Borrowing Requirement (and, incidentally, prevented collapse of the franchising system as franchisees walked away). But, a subsidy is a subsidy regardless of why and how it is politically decided and, if government sets charges below economic costs, then this is a subsidy that will make operating businesses such as West Coast Trains look good. It is nonsense to argue that lower track access charges are economically justified because they reflect "a reduction in costs after renewal and upgrade". The logic points in the opposite direction. An economic charge for West Coast track access would be higher if it were – as it should – to include an element to recover the capital cost of nearly £10 billion spent on the upgrade. Without that cost recovery, lower track access charges cast Network Rail in the role of the philanthropic landlord who first improves your flat at his expense and then reduces the rent so you can keep more of your income.

We have concentrated on the issue of subsidy dependence by laying out time-series evidence because it is important to justify the central charge which Branson denies because it does not fit his imagery of the battler and "mission impossible". But finally we would offer a broader view of the discrepancy between a trade narrative account of West Coast Trains where only the positives appear and a more balanced public interest view of West Coast Trains where the large negatives must figure prominently. Exhibit 5 presents figures that correspond to the visible ATOC trade narrative on the one hand, and the figures for indirect subsidy that are 'shadowed' or partially concealed in that trade narrative on the other. The cumulative totals for different items give whatever we know from publicly available sources for all or part of the whole period from 1997-2012.

Firstly, in the West Coast Train trade account, since 1997 the visible elements will include the stakeholder rewards which include franchise payments of £370 million cumulative together with the dividend payments to investors of £450 million cumulative. Secondly, again in that trade narrative, the sources of revenue will be recognised, with passenger fares being the largest source accounting for £7,834 million cumulative, supplemented by direct government subsidy of £1,909 million cumulative. Trade figures such as Branson will gloss such figures by noting that dividends have not been paid every year and government direct subsidy is declining. Critics, like us, might argue that even in this trade narrative frame, the relativities and relations should be a matter of public concern. The cumulative direct subsidy of nearly £2 billion is more than five times as large as franchise premium payments, while premium payments are smaller than payments to investors of £450 million which, on the evidence of the East Coast line are not necessary.

Exhibit 5: West Coast Trains[17] source of capital, income, subsidies and franchise and dividend payments[18]



[17] Virgin Rail Group, West Coast Trains parent company also owned and operated the inter-city Cross Country franchise from 1997 until 2007.

[18] West Coast Trains annual report and accounts; Stagecoach annual report, 1999, http://www.stagecoach.com/~/media/Files/S/Stagecoach-Group/Attachments/media/publication-financial-reports/ar-1999/financial.pdf; GB rail industry financial information 2011-12, ORR, http://www.rail-reg.gov.uk/upload/pdf/gb-financials-2012.pdf; 'Cost of running the rail network' DfT, https://www.gov.uk/government/publications/cost-of-running-the-rail-network

Source: West Coast Trains report and accounts

Source: West Coast Trains report and accounts

Source: West Coast Trains report and accounts

Source: Stagecoach
The total sum paid is £146.8m in the form of shares (£38.1m), cash and expenses. The transaction generated goodwill of £108.7m. Stagecoach also loaned Virgin Rail Group £20m
http://www.stagecoach.com/~/media/Files/S/Stagecoach-Group/Attachments/media/publication-financial-reports/ar-1999/financial.pdf

Source: West Coast Trains report and accounts

Source: West Coast Trains report and accounts

Source: West Coast Trains report and accounts

Source: GB rail industry financial information 2011-12, ORR

More seriously, the trade narrative leaves much that is negative either invisible or excused (and the problem is compounded by inadequate public disclosure of sums paid by individual companies in track access charges). Thus the £9billion cost of upgrading the West Coast line is ignored or excused on the grounds that it is rectifying a deficit of maintenance which is a legacy of the bad old days of British Rail. Then there is the indirect subsidy through lowered track access charges which is the apparent precondition of West Coast Trains' profitability. It is a matter of public concern that until 2010-11 the ORR did not publish information in a form that would allow us to calculate the cumulative indirect subsidy given to each company via low track access charges[19]. However, the DfT did release 'Cost of running the railway network'[20] on 21st December 2012 which allocated the Network Rail grant to each TOC. The DfT study shows that in 2011/12 West Coast Trains indirect subsidy via Network Rail's was £294m, making it the third highest recipient, after Northern Rail and First Great Western, and equating to 30.5% total costs.

There are also several other public interest matters that have never been publicly discussed because they only emerge after close, expert scrutiny of the accounts of West Coast and associated companies. Most remarkable are the initial capitalisation and resale of the West Coast Trains special purpose vehicle in 1997-8. In 1997 West Coast Trains was capitalised with a £20 million loan from Virgin Rail Group. The next year, in 1998, the Stagecoach accounts show that the shareholders of Virgin Rail Group, owners of West Coast Trains, sold a 49% shareholding to Stagecoach for £147 million. It is difficult to argue that this £127 million capital gain was a reward solely for hard work. Indeed, it looks more like a failure by government to control windfall profit-taking.

[19] http://www.rail-reg.gov.uk/server/show/ConWebDoc.10814 (The ORR estimate the level of indirect subsidy at £294m in 2011/12).
[20] https://www.gov.uk/government/publications/cost-of-running-the-rail-network

Conclusion

There's a tussle going on. It is a tussle about how to manage a railway network. It is an argument about profits and profitability. It is a disagreement about how to *think* about railways and the way in which they get organised. But it is an argument with wider economic and political ramifications too, because it also a disagreement about how what should count as the public good gets – or should get – framed.

So how should we manage a railway network? And what is the place for profit in that system? As we have noted above, on several occasions polls have shown the public thinking that the railways should be renationalised. This is certainly the view of many of the Trades Unions, and indeed of the Green Party. And there is a strong case for this which we have touched on above and not least because Directly Operated Railways have run the East Coast main line service within the public sector and run it well. However, on the issue of ownership we are agnostic. We are more interested in how the railway system might be organised fairly and transparently than we are with ownership as such. Within the British context our railways require direct subsidy to the tune of around £3.9bn a year[21], and Network Rail has separately funded investment by issuing debt which must now be serviced. This means that there is a funding gap of at least £9 billion each year (without considering debt service charges.) If we start from this as a fixed point, then we need to ask: *how* should our railways be subsidised? And *where* should those subsidies go? But at the moment, as a nation, we've got the answers to both of these questions wrong.

How should we subsidise them? At the moment the answer is: by way of a daft fudge. Part of the subsidy is paid directly by the DfT. That's the transparent bit. And part comes from borrowing by Network Rail which issues publicly guaranteed private debt. That's the part that isn't transparent. And it's also building up trouble for the future because the large, publically guaranteed, debt overhang for Network Rail is unsustainable in the long run. To be fair, no one in the industry, TOCs, ROSCOs or Network Rail, is responsible for this idiocy. The Treasury has created the problem within a frame of PSBR rules where off-public balance sheet liabilities do not count. But as things stand, those rules lie at the core of the absence of transparency that afflicts the railway system.

That's the upstream part of the problem. But this feeds downstream. It feeds into where the subsidies go. And the answer is that it's the TOCs that are benefiting. They get varying degrees of subsidy directly from the DfT. We can debate the franchising arrangements, and clearly these are flawed. Nevertheless the subvention here is transparent, it's above board, and it can indeed be easily debated. The bit that isn't above board is the subsidy that comes from Network Rail. As we've shown above, the TOCs don't pay an economic rent to run their trains. Instead they're

21 http://www.networkrail.co.uk/uploadedFiles/networkrailcouk/Contents/Publications/Annual_report_and_accounts/2012/NRL_AR2012.pdf

being indirectly subsidised. This again is scarcely the fault of any of the players in the industry, but it's a windfall operating gain as a consequence of Treasury and DfT decisions which lead to opacity.

Here's where the TOCs become players. They're being subsidised both directly and indirectly. But it serves their purpose to deflect attention from the indirect part of the subsidy. For several reasons. It helps them to make a profit. And it helps them to create trade narratives about their operations in which they present themselves as go-getting entrepreneurs that are in the business of creating value. But they aren't entrepreneurs in any Marshallian risk-taking sense. As we argued above and in *The Great Train Robbery*, they are renting trains and (subsidised) track slots, and they are running their services more or less well. But what they aren't doing is putting any substantial amount of capital at risk either in the operating SPV or in the parent companies which does not guarantee franchise payments in loss making franchises. The downside risk is limited as long as franchisees can walk away from unprofitable franchises with a net gain even if franchise rule changes impose higher penalties which are now making this more expensive. No doubt train operating companies deserve to be paid some kind of fee for management services. We can debate whether 3% or 1% of turnover is the right level. But what they don't deserve is a stellar return on capital without taking risk.

This is the point where the trade narratives that accentuate the positive and eliminate the negative start to become politically dangerous for the rest of us who participate not only as fare-paying rail users but also as taxpayers and as voters deliberating between different party agendas. A trade narrative is a story that tells how private interest coincides with and helps to enhance the public good. It is motivated by the need to align the two. Or, more negatively, it is motivated by the need to frame the public good in a way that coincides with the pursuit of private interests. Of course some trade narratives are persuasive for good reasons. In the abstract there is no intrinsic reason why private interest and public good cannot sometimes be aligned. Even so, when citizens and voters are faced with trade narratives they need to be wary. The question is always about what trade narratives leave undisclosed as shadowy negatives, or what they excuse and explain away as no problem or as somebody else's fault.

And this has been the core of the argument that we've made above. We have suggested that the TOC trade narratives work by marginalising one of the most important parts of the railway finance story. This is because they make no space for Network Rail's hidden subsidy – the uneconomic track fees that it charges the TOCs. As a part of this, they make no space to talk about the growth of Network Rail's debt. And, again as a part of this, they avoid talking about what might happen in due course when that mountain of debt becomes more unsustainable; as we have pointed out, Network Rail is already spending more on debt service than it spends on track maintenance. And these negatives are in the shadowy area of the undisclosed in the TOCs trade narrative because if the negatives were taken seriously it would do them reputational damage. It would put their profits at risk, threaten their business model which is levered on state subsidy, and raise questions about the entrepreneurial story which lies at the core of their sheltered businesses. Perhaps they believe they are swashbuckling entrepreneurs, or perhaps

they don't. It doesn't really matter. They are actually in a risk-free business, but they cannot afford to acknowledge that this is the case.

And then there is what might be called the secondary political effects. This is because the independent civil service cannot safeguard the public interest if it has become an uncritical consumer of trade narratives. The Treasury and the DfT are entirely complicit in what's going on in rail because, as Richard Branson notes, it is successive governments (New Labour and Coalition) that set the rules of the game. But the absence of transparency then has friends on every side because the civil service can avoid blame by celebrating privatised success (and preventing embarrassing failures), while the trade narratives bolster rules and decisions which deflect attention from awkward negatives that don't fit. Furthermore, when politicians and civil servants endorse trade narratives, what they say circulates widely and helps to shape what can be said – or said and taken seriously – in the public domain. Which, to repeat the point, is why we need to be exceptionally wary of trade narratives.

The corruption of politics is completed when the work of the trade associations is redefined, in the post-Thatcherite style, as lobbying supported by a trade narrative. Trade associations have an honourable place in our polity if their pursuit of private interests is moderated by some recognition of where private and public interests can and do diverge. But this is exactly what trade associations like ATOC or the British Banking Association cannot do. ATOC would be truly worthy of respect if it wrestled in public with the down-side of the present arrangements. It would be truly worthy of respect if it commissioned reports that were seriously researched. It would be truly worthy of respect if it didn't cherry-pick positives from the available statistics in order to confect a case for the present unsustainable *status quo*. It would be truly worthy of respect if the stories that it told worked to increase rather than to decrease transparency. But that is not how it has been up till now. And the damage to transparency – and to public debate about how to think about how to run a sustainable railway – has been very serious.

Democracy requires deliberation and it cannot flourish when trade narratives are allowed to define what counts as the public good in a world where private interests and the common good often do not coincide. The idea of 'regulatory capture' is familiar from public choice theory. Here the mass of the population has no material incentive to resist the focused depredations of individuals or small groups. After considering sectors like rail and finance, we would propose a different concept of *narrative capture* which works through story-telling. This can be pervasive and insidious because it defines what can be said and taken seriously (or not) by political elites and masses. And this is close to what has happened in the UK for the railways and public policy. Fortunately we aren't quite there. The ORR report we cited above gestures at Network Rail's future financial problems. Independent experts such as Roger Ford and Christian Wolmar have respected positions which allow them to stand back, ask dispassionate questions and present informed arguments. Parts (but only parts) of the daily and regional press have also asked awkward questions, and the trade press is well aware of the difficulties. But ATOC has thus far refused to step outside its trade narrative. And political debate about the consequences of

Network Rail's deficit has been confined to the margins. This is narrative capture or something very close to it. It is bad for our railways. And it is bad for democracy.

By virtue of paragraph(s) vi of Standing Order 17.42

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Y Pwyllgor Menter a Busnes
Enterprise and Business Committee

Edwina Hart AM
Minister for Economy, Science and Transport
Welsh Government

23 October 2013

Dear Minister

Welsh Government Draft Budget Proposals 2014-15

I wish to thank you and your officials for attending the Enterprise and Business Committee meeting on 17 October as part of our scrutiny of the draft budget proposals 2014-15. As I mentioned during the meeting, we are grateful that the level of detail provided in your budget paper responded to the requests set out in my letters dated 5 August.

The main focus of our budget scrutiny this year has been on budget prioritisation and value for money. We have been keen to make a clear distinction between monitoring and evaluation. Our scrutiny has also concentrated on whether your policies have contributed to achieving relevant Programme for Government objectives such as creating jobs, promoting growth and tackling poverty.

We have also considered this year how preventative spending is considered in your policy development, that is, spending that focuses on preventing problems and easing future demand on services through early intervention.

The Committee has set out a number of recommendations for your considered response. We are also sending this letter to the Chair of the Finance Committee to inform that Committee's overarching strategic scrutiny of the draft budget. Both this letter and your response will be published on our website.

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1. Economy, Science and Tourism

<u>Value for money</u> – progress against Programme for Government and departmental performance

Our scrutiny aimed to explore whether the Welsh Government is spending its allocations efficiently and effectively - that is, whether your departments are securing the best outcomes for the resources and other inputs employed.

You kindly offered to provide us with six-monthly updates on progress against your Programme for Government commitments.

Recommendation 1
We welcome your offer to provide six-monthly updates on progress against your Programme for Government commitments. We should be grateful if those updates could include information on the number of jobs created, safeguarded and assisted by the department, as well as information on the number of inward investment jobs actually delivered by the department (as opposed to the wider UK Trade & Investment figures based on announcements).

The Committee is very keen to carry out more financial scrutiny next year, particularly to look in detail at the outputs achieved against expenditure during 2012-13 and to track the on-going performance of your department. We therefore suggest linking this from now on with your six-monthly updates.

Recommendation 2
As part of your six-monthly update, we should be grateful if you could provide a table that sets out the outputs achieved by each individual programme/area of activity along with information, where possible, on the associated expenditure. We would also be grateful if you could include this information in your six-monthly transport updates, and for the first update to be provided in February 2014 to enable us to carry out in-year scrutiny of the supplementary budget.

<u>Value for money</u> – evaluation of programmes

We welcome the comment from your officials that your department evaluates all of its programmes and accounts for any deadweight and displacement.

Recommendation 3
We should be grateful if you could provide us with a list of the programmes that have been evaluated and the dates of the evaluation reports.

<u>Value for money</u> – Enterprise Zones

We look forward to seeing the performance data for Enterprise Zones that will be published before the end of the year and we are pleased that you confirmed that this will include specific, measurable and timed targets for 2014-15.

<u>Prioritisation</u> – financial support for business

Our scrutiny of prioritisation within your portfolio centred on whether the division of budget allocations between different programmes is justifiable and coherent.

During our discussion on financial transactions funding, we heard that you were waiting for further detail from HM Treasury as to the timescale for the proportion (80 per cent) of the funding that will have to be repaid, and on what terms, to the Exchequer.

Recommendation 4
We would be grateful if you could provide us with a further note on financial transactions funding once you have received confirmation from HM Treasury.

We also discussed the balance between traditional grant support and repayable loans although we would welcome greater clarify on this point.

Recommendation 5
We would welcome a note clarifying the exact amounts your department allocates to both grants and loans, and also how the outputs and effectiveness of each are monitored and evaluated.

<u>Budgetary processes</u> – sectors policy

We discussed how you assess the equality impacts of your decisions and whether you include sustainable development assessments as part of your budget processes. We appreciate the frank response you gave us that this is

often difficult to achieve, but that you consider equality and sustainable development as part of your regular quarterly reviews.

In particular, we very much welcome your offer to provide a note on how you have considered the equality impacts of the sectors policy, particularly with respect to the gender imbalances within the priority sectors.

Recommendation 6
You kindly offered to give further consideration to the improvements that could be made by your department in carrying out Equality Impact Assessments. We should be grateful if you could provide a note on your department's approach to assessing the equality and sustainable development impacts of its actions.

2. Transport

Affordability – revenue funding

We are concerned about the impact of the reduction of revenue funding in the transport budget on your department's ability to meet its statutory and contractual obligations and to preserve/enhance essential public transport services.

Recommendation 7
We would be grateful to receive as soon as possible an update on progress to address the reduction on revenue funding in addition to the information provided following the next supplementary budget.

Prioritisation – Active Travel Bill

Regarding our discussion on the delivery of the Active Travel (Wales) Bill, we would welcome further clarity on the cost estimates on which the budget allocation for delivering the Bill are based, and how delivery of the Bill will be coordinated with the Department for Culture and Sport. We understand that the Finance Minister has stated that where the delivery of legislation results in higher than expected costs, the relevant Minister will be expected to find the additional funding from within his or her portfolio.

Recommendations 8, 9 and 10
We should like you to clarify which aspects of the Active Travel Bill are the responsibility of the Minister for Culture and Sport and which

aspects are the responsibility of the Minister for Economy, Science and Transport, and the budget allocated in both portfolios.

We would like further clarification on who is responsible for the development and delivery of the Active Travel Plan which accompanies infrastructure interventions, as referred to in the Active Travel Bill's explanatory memorandum. Please could you also clarify whether any provision has been made for the development and delivery of the Plan in your draft budget.

You also offered to provide us with information on how capital allocations for sustainable travel relate to the delivery of the Active Travel Bill.

<u>Value for money</u> – bus services

Regarding the funding of bus services, particularly the Regional Transport Services Grant, we understand that you plan to evaluate the effectiveness and impact of the new funding arrangements. We welcome your offer to talk to the Committee about your future plans. In the meantime we would appreciate clarification on the funding for Community Transport and on the Regional Bus and Community Transport Network Strategies.

Recommendations 11 and 12
Please could you clarify the status of the Regional Bus and Community Transport Network Strategies currently being developed by the Regional Transport Consortia given the wider review of regional transport planning and provision of bus services that you referred to in your oral evidence.

Please could you clarify whether the "effective doubling" of the funding for Community Transport, which you referred to, includes funding previously allocated for the Community Transport Concessionary Fares Initiative.

<u>Value for money</u> – National and Regional Transport Planning

In your evidence you referred to the "shortfall in the current arrangements" to evaluate the cumulative and longer-term effects of the National Transport plan, as opposed to the evaluation of individual schemes. We would

appreciate more information on this issue, including the affordability of current capital commitments.

Recommendations 13 and 14
Could you explain how you will address what you describe as the shortfall in arrangements to evaluate the National Transport Plan, including the timeframe for this work and how evaluation, as opposed to monitoring alone, will be built into the next National Transport Plan from the development stage.

You said that the timeframes for the four-stage process for developing the next Regional Transport Plans outlined in the paper to Cabinet on 19 February 2013 had not changed. Could you provide assurance that plans will be in place by 1 April 2015, and update us on the outcomes from Stage One of the process.

<u>**Value for money**</u> **– Metro**

We welcome your offer talk to the committee about the proposals for a Metro for the Cardiff region, and as you will be aware, we have a session planned for 5 December to talk about the issues in detail. In the meantime we would appreciate more information on progress made on the costed delivery plans, which you confirmed would be produced.

Recommendation 15
We should like to know when you will be in a position to provide the costed delivery plans for both the South East Wales Metro and the North East Wales Integrated Transport Interventions.

Thank you for assisting the Committee in our scrutiny work. We look forward to receiving your response to the points raised in this letter.

Yours sincerely

Nick Ramsay AM, Chair, Enterprise and Business Committee

cc Jocelyn Davies AM, Chair, Finance Committee

Edwina Hart MBE CStJ AC / AM
Gweinidog yr Economi, Gwyddoniaeth a Thrafnidiaeth
Minister for Economy, Science and Transport

Llywodraeth Cymru
Welsh Government

Ein cyf/Our ref EH/03565/13

Nick Ramsay AM

Nicholas.ramsay@wales.gov.uk

7 November 2013

Dear Nick

Welsh Government Draft Budget Proposals 2014-15

Further to your letter of 23 October, following the Committee's Budget Scrutiny meeting on 17 October, please find my response to your recommendations below:

Economy and Science

Value for Money

Recommendations 1 & 2 – Programme for Government and Departmental Performance

I will provide the Committee with a six monthly update in February 2014 as requested to support the supplementary budget scrutiny.

Recommendation 3 - Evaluation of Programmes

This information is not held in one source. A further response will be provided to the Committee once the information has been collated.

Prioritisation

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Recommendation 4 - Financial Transactions

I will provide you with information in relation to financial transactions funding when the confirmation has been received from HM Treasury.

Recommendation 5 - Financial Support for Business

In 2014-15 financial support to business of £101m is available within the Sectors and Business Spending Programme Area. The budget includes £12m grant funding for legacy SIF projects and specific additional allocations for the following:

a) The Wales Economic Growth Fund – Phase 2 £20m which is a non-repayable grant fund for projects requiring £100,000 or more to stimulate economic growth and create and/ or safeguard employment.

b) Financial Transaction Funding - £12m which will be used to expand or create new funds to be managed by Finance Wales. As discussed in the Committee the funding can only be used for loan and equity investments.

There is no specific allocation between grants and loans for the remaining core budget which also supports sector development activities. We continue, where appropriate, to offer repayable business finance to assist businesses. The nature of support is bespoke and discretionary and targeted to deliver against the Programme for Government's overriding priority for growth and sustainable jobs. There is also wider consideration of Welsh Government priorities in terms of tackling poverty and supporting communities. Therefore we need to remain flexible to respond effectively to the needs of businesses in Wales. Each proposal is assessed in terms of value for money and is subject to rigorous appraisal and due diligence.

Alongside our core budget there are loan and equity investments by Finance Wales, which support economic development. Future investments will build upon over £250 million of funds currently under management by Finance Wales which deliver over £30m additional investment in SMEs each year. In terms of economic sustainability many of these funds can be reinvested many times.

I will update the Committee as part of the six monthly report against Programme for Government and departmental performance.

<u>Budgetary Processes</u>

Recommendation 6 – Sectors Policy

Equality Impact Assessment

Equality considerations are integral to our 2014- 15 Draft Budget decisions and any significant funding changes have and will be considered against their impact on individuals with protected characteristics. The Department is taking further steps to ensure that the Equality Impact Assessments are current and fully support spending decisions. The ability to analyse evidence effectively and better understand the process as part of the budget considerations has been recognised as areas for improvement.

Currently the equality impact assessments for the priority sectors are being drawn together in a consultation document. In improving the process the formal approach to assessing equality the assessment is supported by four stages:

1. Research and data collection using national statistics, studies and publications
2. A systematic review of the Sector activities
3. Consultation and involvement of internal and external stakeholders
4. Action plan development

The Action planning stage is vital and is focussed on positive, productive and achievable commitments. Each Head of Sector has ownership and responsibility for delivering the actions.

Involvement is being rolled out primarily through representative organisations for each of the protected characteristics. Involvement of people sharing some protected characteristics such as transgender individuals is known to be more challenging. This is therefore being approached on a more incremental basis.

In developing understanding and knowledge of human rights, rights of the child, Welsh Language and equality legislation a programme of learning has been delivered across the Department. A series of workshops were convened by the Director of Finance as part of the communication strategy.

The Department has dedicated specialists who support teams in each Sector in evaluating the equality impact assessments, particularly support and advice in presenting robust evidence and research for decision making.

Research has identified that there is a gender imbalance across the priority sectors. In making decisions there are examples where evidence and commitments were actioned in the priority sectors and the wider business support to assist people sharing protected characteristics:

- Creative Sector – the "Mostly Women Doing Digital" event was held to encourage women in the sector.
- Marketing – differentiated marketing of EST business support such as WEGF 2 which raises the profile of schemes amongst people sharing protected characteristics.
- Advanced Materials and Manufacturing Sector – positive promotion of pre-apprenticeship Saturday Clubs to girls.
- ICT Sector – support for 30 women to take part in Women Adding Value to the Economy project in web design and management.
- Entrepreneurship and Business Information – project approved to deliver awareness sessions to Welsh Business's on employment of people with Autism.
- Finance and Professional Services Sector – early stages of developing a Wales approach to moving women into higher board positions through linking with Financial Skills Partnership.
- Life Science Sector – aiming to attract high profile female speakers and positively promoting the event to maximise a diverse representation at International BioWales Conference.

Sustainable Development Assessment

Sustainable development by its very nature is long term and complex, and economic development outcomes are equally as important as social and environmental outcomes to delivering against this overarching principle. The current approach to considering sustainable development is a coordinated and structured assessment across the whole of Welsh Government; reported annually in the Sustainable Development Annual Report, the Sustainable Development Indicators for Wales Annual Report and the Climate Change Strategy for Wales Annual Progress Report.

The Department continues to embed sustainability into policy, projects and programmes as part of the decision making. Some examples are provided as follows which illustrate the importance of the wider impact of business solutions in the priority sectors:

- Property and physical development schemes are assessed by the Property Leadership Team. Appropriate terms and conditions are placed on projects with regard to the sustainable building standards required by the Welsh Government. BREEAM, the Building Research Establishment Environmental Assessment Method, is the methodology used to assess all projects. Environmental assessments on our development sites are also carried out where required to ensure that environmental standards are met. As an example, the development of Porth Teigr in Cardiff Bay has achieved high standards of sustainability.

- From a business development perspective our main focus is the sustainability/viability of the business going forward. All funding

proposals are considered by the Investment Panel within EST and apply this principle when assessing projects that are seeking our support.

- Sustainability is prioritised and embedded in in all major projects from the outset such as the delivery of Next Generation Broadband Wales (NGBW).

Monitoring and assessment procedures are in place to assess a wide range of economic, social and environmental sustainability objectives, including areas such as local employment, training and development of local supply chains, waste minimisation and recycling, environmental impact assessments and carbon footprinting. A Waste Management Plan is being put in place as is a Low Carbon Impact Strategy, and an Environmental Management System that will comply with British Standards.

I am committed to better understanding the nature of inequality and embedding sustainable development across my portfolio and ensuring that decisions align to the priorities of Welsh Government in tackling poverty and delivering growth and jobs.

Transport

Affordability

Recommendation 7 - Revenue Funding

I recognise that the revenue position facing my Department is very challenging and will ensure that the Committee is updated on the outcome of the commercial negotiations that we are undertaking following the next supplementary budget.

Prioritisation

Recommendations 8, 9, and 10 – Active Travel Bill

I have been working closely with the Minister for Culture and Sport during the passage of the Active Travel (Wales) Bill through the Assembly.

Work on the Bill has been led by officials working in the Economy, Science and Transport Department and I have provided a member of staff on secondment to support the Minister for Culture and Sport's wider work on active travel, including the recent Cycling Nation conference.

The implementation of the Active Travel Act is primarily a matter for my Department. Officials in my Department are leading on the development of the direction designating places to be covered by the mapping requirements in the

Bill, the Delivery Guidance and the Design Guidance. The budgets that provide for the development of the Design Guidance and which will support the development of the Existing Routes and Integrated Routes maps are in my portfolio. As was reported to the Committee, I have allocated £0.352m next year for these activities.

The capital budgets that provide for expenditure on the active travel infrastructure which will be delivered in response to the Bill are primarily a matter for me.

The Minister for Culture and Sport was clear throughout the passage of the Bill that expenditure on infrastructure will come from existing funding but that funding would now be much better directed at routes that would make a real difference to people's mode choice.

I currently fund local authorities to provide walking and cycling infrastructure through two main grant programmes, namely Safe Routes in Communities and Regional Transport Consortia Grant. In future local authorities will need to deliver it to a consistent (not necessarily more expensive) standard as a result of the design guidance, and to focus on issues of connectivity and promoting the use of routes.

It is the case that investment by other Ministers will also contribute towards the delivery of the Active Travel Act. The Minister for Health and Social Services, for example, funds a range of programmes that encourage uptake of walking and cycling as part of health promotion activity.

The Active Travel Action Plan, which will be published for consultation shortly, is a cross-Government plan and contains actions that are the responsibility of a number of different Ministerial portfolios.

As well as the allocations in my portfolio noted above, it is anticipated that the Plan will include actions with budget allocations made by the Minister for Culture and Sport, the Minister for Health and Social Services and the Minister for Natural Resources and Food.

The only resources required for the development of the Action Plan are staff costs and very minor costs for hosting consultation events.

The Sustainable Travel Budget Expenditure Line (BEL) includes allocations that will support the delivery of schemes that are in line with the objectives of the Active Travel (Wales) Act to create integrated networks for walking and cycling. This includes an allocation of £2.4m (£0.7m in 2014-15 and £1.7m in 2015-16) from central capital to deliver walking and cycling improvements as part of the Metro in 2014-15 and 2015-16. The BEL also includes allocations for Safe Routes in Communities and Trunk Road Walking and Cycling Interface schemes.

Value for money

Recommendations 11 and 12 – Bus Services

The Regional Bus and Community Transport Network Strategies have been developed to enable the Regional Transport Consortia to identify where bus funding should be directed.

It was necessary that these were developed now but it was always envisaged that they would be developed and refined over time. I would expect the long term planning of services to form part of any wider transport planning exercise.

The previous Minister commissioned pilots for Community Transport Concessionary Fares Initiative. The outcome of this pilot was that the initiative should not be taken forward.

The Community Transport Concessionary Fares Initiative pilot was not factored into the comparison of funding for community transport this year and last year because the Community Transport Concessionary Fares Initiative pilot was restricted to just 15 operators.

In 2012-13 community transport had access to some £0.9m through Local Transport Services Grant; and around £350,000 from the Bus Service Operators Grant. In total the funding is about £1.25m. Those schemes ended on 31 March 2013. On 1 April 2013 a new scheme, Regional Transport Services Grant (RTSG) came into being. Community transport has access to up to £2.5m from RTSG in 2013-14 subject to there being worthwhile schemes to support. Therefore this has resulted in an effective doubling of funding.

Recommendations 13 and 14– National and Regional Transport Planning

I have instructed my officials to undertake a review of both National and Regional Transport Planning, including how to deal with the issue of understanding system wide effects of transport interventions as well as scheme by scheme evaluations. I will report back to the Committee on the outcome by Easter 2014.

It is important to put the scale of the task of producing future transport plans in context. When the current National Transport Plan and Regional Transport Plans were developed, they were a new process and substantial time and resources went into their production. This time we can build on that previous work and focus our effort on addressing what has changed in the time since the current plans were produced and how this should be reflected in updated plans.

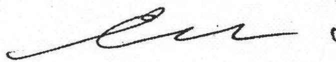
As I stated in Committee I intend to meet the timetable previously outlined. The first stage of the work has been focused on data gathering and establishing the evidence base. This work has put us in a much better place to identify where transport improvements are required to deliver our objectives and to test different transport interventions.

Recommendation 15 - Metro

The delivery plans for interventions arising from both these reports will be considered as part of the work to develop future transport plans. Further detail will be available through next year.

Mark Barry's report includes indicative costings for the recommended Metro interventions. The Metro Implementation Group that I am establishing will look at these costings in detail and report back to me. In addition, I will shortly be issuing the full Metro report to all members for their information. As I said in Committee, once Members have had the opportunity to consider the full report I will be more than happy to arrange for a technical briefing session at Committee.

I would like to thank the Committee for the positive discussion of the issues in delivering the budget priorities for growth and jobs in particularly challenging financial times.



Y Pwyllgor Menter a Busnes
Enterprise and Business Committee

Cynulliad
Cenedlaethol
Cymru

National
Assembly for
Wales

Huw Lewis AM
Minister for Education and Skills
Welsh Government

23 October 2013

Dear Minister

Welsh Government Draft Budget Proposals 2014-15

I wish to thank you, the Deputy Minister and your officials for attending the Enterprise and Business Committee meeting on 17 October as part of our scrutiny of the Welsh Government's Draft Budget Proposals 2014-15.

As I mentioned during the meeting, we are grateful that your budget paper was detailed and responded to the requests set out in my letter to you dated 5 August 2013 for information on preventative spend and prioritisation of Programme for Government commitments.

The main focus of our budget scrutiny this year has been on budget prioritisation and value for money. Our scrutiny has also concentrated on whether your policies have contributed to achieving your three cross-cutting themes of jobs and growth, educational attainment and supporting children, families and deprived communities.

The Committee has made a number of recommendations for your considered response.

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We are also sending this letter to the Chair of the Finance Committee to inform that Committee's overarching strategic scrutiny of the Draft Budget. Both this letter and your response will be published on our website.

<u>Prioritisation</u> – post 19 skills education and women learners

We appreciate that you have had to make difficult decisions this year to manage the 4.7 per cent actual reduction in the Education and Skills budget. It was confirmed in the evidence session that Welsh Government funding for 16 to 18 year olds in further education will be prioritised over that for those aged 19 years and above.

Recommendation 1
Please could you provide us with your assessment of the effect of your budget proposals on the numbers of students and numbers of courses in the post-19 cohort?

Given that grant levels and eligibility thresholds will be frozen for all student finance grants (for example, Assembly Learning Grants, Targeted grants and part-time grants) from 2014-15 until 2016-17, we are very concerned that this could result in a "double disadvantage" for female learners. This is because female students make up a larger proportion of learners overall and because women make up a greater proportion of older learners (aged 19 plus). Indeed, this is recognised in the Welsh Government's Equality Impact Assessment of changes in full-time education provision.

Recommendation 2
We welcome your commitment to monitor and evaluate the impact of your budget proposals on female learners over the age of 19 and we would like to receive details from you on how you propose to carry out that monitoring and evaluation and over what timescale.

<u>Prioritisation</u> – post 19 skills education and female apprenticeships

Regarding funding for apprenticeships, the Deputy Minister said that future support would be targeted at priority areas and he listed some non-priority sectors such as hair, beauty, retail and business administration. Again females tend to dominate these sectors.

Recommendation 3
We would like to have a better understanding of the Welsh Government's rationale for prioritising support for certain apprenticeships, the likely impact of decreased support for non-priority apprenticeships on women in particular, and clarity regarding how the savings will be reinvested in other areas, and with what intended outcomes.

Value for Money – reconfiguration of higher education

There is no planned increase in the indicative higher education budget for 2014-15, and we know that the Assembly's Finance Committee will be carrying out an inquiry into the funding of higher education later this term. You kindly agreed to provide information about the breakdown of savings made as a result of higher education mergers which have occurred over the last ten years.

Recommendation 4
We should be grateful to receive detailed information regarding the costs of the higher education reconfiguration policy over the last ten years and what evaluation has been undertaken to check whether the mergers have been good value for money.

Value for Money – Financial Contingency Fund

You also offered to provide us with a copy of the evaluation study of Financial Contingency Funds, undertaken by Oldbell3 last summer.

There were two other areas which you said you would be monitoring and evaluating in the near future:

- the widening access to higher education resource; and
- any potential impact in Wales of the policy in England not to restrict the numbers of "ABB" higher education students on individual courses.

Recommendation 5
We would be grateful to receive updates on these two areas as soon as possible.

Budgetary processes

Unfortunately we ran out of time during the scrutiny session to ask you about sustainable development appraisals.

Recommendations 6 and 7

We should be grateful if you could provide us with a note on whether a sustainable development appraisal of your departmental budget was carried out as part of the budget planning process, and if yes, what changes were made as a result.

We should also like to know how your department's resources will be used to deliver the sustainable development commitments contained in the Programme for Government, and how the relevant outcomes will be measured.

Thank you for assisting the Committee in our scrutiny work, and we look forward to receiving your response to the points raised in this letter as soon as possible.

Yours sincerely

Nick Ramsay AM
Chair, Enterprise and Business Committee

cc Jocelyn Davies AM
Chair, Finance Committee

Huw Lewis AC / AM
Y Gweinidog Addysg a Sgiliau
Minister for Education and Skills

Llywodraeth Cymru
Welsh Government

Nick Ramsay AM
Chair Enterprise and Business Committee
National Assembly for Wales
Cardiff Bay
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11 November 2013

Dear Nick,

Thank you for your letter of 23 October requesting further information following the budget scrutiny by the Enterprise and Business Committee on 17 October. I have set out below responses to the issues you raised and the additional information you requested.

Post 19 skills education and women learners

It is difficult to gauge the exact impact of budget proposals on numbers of learners and courses as Welsh Government funding is not the only income stream for Further Education Institutions.

Based on the most up-to-date data available the cost of an average post-19 learner is £558 per annum. The average number of hours for a part time learner is 60 hours. Therefore, with no presumption of cost savings or alternative income streams, the reduced budgets could result in as many as 68,000 fewer part-time learning opportunities being made available to learners in 2014/15.

My officials will work closely with the post-16 sector to minimise the impact of any reductions in learning and we estimate that far fewer learners will be impacted.

It is currently not possible to project the number of courses that may be impacted. Whilst smaller less viable classes are those most likely to be targeted, FE institutions have responded well to the transformation agenda, resulting in many larger merged colleges with the capacity to offer more efficient larger group sizes.

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Monitoring of post-16 provision is a key element of the new Planning and Funding Framework. Monitoring, to include gender and age monitoring, is scheduled to take place at the end of each academic year. At this stage we will be able to compare delivery patterns on an annual basis and if a gender differentiation occurs, consider introducing measures or priorities to counter this. In the meantime my officials will work closely with the post- 16 sector to minimise the impact of any reductions on specific groups of learners.

Post 19 skills education and female apprenticeships

My officials work with colleagues in Department for Economy Science and Transport to determine which sectors are considered priority for the Welsh Government. Priority areas such as Construction and Engineering will drive growth and prosperity within the Welsh economy and we are working to increase the participation of women on Apprenticeships within these sectors Service industries such as hair and beauty, retail and business administration are treated as non-priority in our allocations process.

When considering the allocation of finite Apprenticeship funding, the following priorities are applied:

- Those in learning, whose learning continues into the new contract year
- All new entrants aged 16-24, irrespective on any sector priority
- Higher apprenticeship, irrespective of sector priority
- New entrants aged 25+ in priority sectors
- New entrants aged 25+ in non-priority sectors.

For the 2013/14 contract year, we have approved funding based on demand for apprenticeship places in the 16-24 year old, higher apprenticeship and priority cohorts. This has meant that funding has been fully allocated and non-priority entrants aged 25 plus are not planned. Further, apprenticeship places allocated from the additional £20m announced in Final Budget 2013-14 have been prioritised towards Higher Apprenticeship and 16-24 year old recruitment.

As part of our application for European Social Funding to support the Apprenticeship programme, my officials submitted a business plan to the Wales European Funding Office (WEFO). This plan includes targets for female participation.

In addition Estyn have been commissioned to review equality issues on the Apprenticeship programme, looking specifically at the possible barriers faced by individuals from black minority ethnic and disable groups when wanting to engage in the apprenticeship programmes. In addition we have asked them to consider gender balance across occupational sectors. Estyn will produce its final report in January 2015, and this will be used to inform our policy thinking on how to engage more effectively with disadvantaged groups and will tackle gender stereotyping.

Reconfiguration of higher education

From 2002 to 2011, the Higher Education Funding Council for Wales' (HEFCW's) Reconfiguration and Collaboration Fund supported the reshaping of the higher education (HE) sector in Wales in order to achieve major performance gains and enhanced competitiveness.

Funding of £15 million was provided to assist with the merger of Cardiff University and the University of Wales College of Medicine in 2004. An independent evaluation of both the merger process and the subsequent progress towards the goals for the merged institution highlighted the success of the merger process as well as the growth in research funding

awarded to the University since the merger. A further independent evaluation of the impact of the merger in 2010 examined the outcomes of the merger and lessons for future merger developments.

Funding of £12.75 million was provided to support a strategic alliance between the Royal Welsh College of Music and Drama and the University of Glamorgan, with the College becoming a subsidiary of the University in 2007. An independent evaluation examined progress towards the goals for the Strategic Alliance and lessons for future merger developments.

Funding of £14.3 million was provided to fund the merger of University of Wales, Lampeter and Trinity University College, Carmarthen in 2010.

The evaluation reports are available on HEFCW's website:

http://www.hefcw.ac.uk/policy_areas/strategic_change/reconfig_collab.aspx

In line with the current Programme for Government commitment to establishing fewer, stronger HE institutions, we have continued to develop the policy of reconfiguration in the sector. The two specific recent examples which represent a significant contribution to fulfilling this commitment are as follows:

On 11 April, the University of Wales, Newport and the University of Glamorgan merged to form the University of South Wales. In order to ensure a smooth transition to the new institution, we have made available, through HEFCW, additional funding of £24.8m (revenue and capital) over three years.

In August 2013, the University of Wales: Trinity St David (UWTSD) merged with Swansea Metropolitan University. £3.2m is being made available via HEFCW to support this merger.

In line with established practice, it is expected that any future evaluation of these most recent mergers will consider the benefits of merger (financial and otherwise) and whether the projected efficiency savings and re-investments have been fully achieved.

The Wales Audit Office's (WAO's) interim evaluation of the Reconfiguration and Collaboration Fund overall in 2009 recorded that HEFCW generally managed the fund well and some HE institutions were engaged in successful collaboration projects. The WAO also found that merged institutions were stronger, had increased research capacity and developed a broader teaching provision as a consequence

Financial Contingency Fund

A copy of the Oldbell3 evaluation of Financial Contingency Funds can be found at the following link:

http://wales.gov.uk/about/aboutresearch/social/latestresearch/evaluation-financial-contingency-fund/?lang=en

Sustainable Development

Sustainability is our core organising principle. There is a focus on economic, social and environmental sustainability.

The line by line review of the budgets that I and my officials undertook for this draft budget included the impact of decisions on sustainability, equality, the rights of the child and the welsh language. Sustainability is not considered in isolation but is an integral part of the

decision making process. It is about taking decisions whilst understanding the full impact of them.

Sustainability is an overarching concept, so it is not possible to pinpoint decisions specifically made because of sustainability. I would not expect any proposals to be put forward that had a negative impact on sustainability. This budget has been all about prioritising investment in areas that have the most positive impact.

As an example, our Youth Engagement and Progression Framework Implementation Plan takes into account the core principles of sustainable development which were incorporated throughout its development. There are clear social and economic impacts that the Plan will contribute to. The development of a consistent and effective approach to early intervention, targeted supported and increased participation in education, training and sustained employment will help to increase wellbeing, overcome generational issues, and embed education, training and employment trends for generations to come.

Similarly, our 21st Century Schools Programme aims to deliver sustainable school buildings. We will continue to work with local authorities to ensure that all new school buildings capital projects meet the Building Research Establishment Environmental Assessment Method (BREEAM) `excellent' standard. The standard ensures best practice in sustainable design and has become the de facto measure used to describe a building's environmental performance. Thirty-five transitional projects will achieve this by 2014-15.

In terms of measuring the impact of these schemes we have outcome measures within the Programme for Government that are reported on an annual basis. These measures give an indication of the success and attainment levels of young people which in turn impacts on their ability to maintain employment and contribute to the economy and society. These include:

- Percentage of children achieving the expected level of learning or above at the end of the Foundation Phase
- Key stage 4 results for 15 year olds
- Percentage of 16 -18 year olds and 19-24 years olds who are not in education, employment and training

I trust that this response is sufficient to answer your additional questions. I will respond on recommendation 5 in due course.

Yours,

Huw Lewis AC / AM
Y Gweinidog Addysg a Sgiliau
Minister for Education and Skills

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